

BBB Cautions Against High Cost Payday Lenders

Payday loans can be tempting. Advertisements promising money to "tide you over until your next paycheck" appear at check cashing outlets, in pawn shops, within the classified ads and increasingly, online. Cyberspace is the new marketing frontier for payday loans with check-based lenders promoting their services through pop-up ads, in junk e-mail and on Web sites. While those "cash until payday" services sound helpful, consumers need to know the risks. Cash-strapped consumers can find themselves enmeshed in an endless cycle of repeated borrowing at extremely high costs.

Small, short-term, high-rate loans are marketed under a variety of names: payday loans, cash advance loans, check advance loans, post-dated check loans or deferred deposit check loans. To obtain the payday loan from a storefront lender, a consumer writes a check payable to the lender for the amount he or she wishes to borrow plus a fee. The lender gives the borrower the amount of the check, minus the fee. The lender then holds the borrower's check until his or her next payday, when the borrower can do one of three things: allow the check to be cashed, redeem it by paying cash to recover the loan plus a fee or roll it over by paying the fee to extend the loans for two or more weeks.

If the borrower chooses an Internet payday lender, the loan is applied for online and the funds are delivered and collected through electronic fund transfers between the lender and the borrower's bank account. The loan is based on electronic access to the borrower's bank account.

While borrowers must have a bank account in relatively good standing and a source of income or benefits to qualify for payday loans, the lenders typically do not perform conventional credit checks. Some borrowers complain to the Better Business Bureau that the lenders encouraged them to write checks without funds for deposit and then used those checks to coerce them to extend their loan. Called "loan flipping" this practice can trap vulnerable consumers in debt.

Under the Truth in Lending Act, the cost of the payday loans - like other types of credit - must be disclosed. Among other information, a consumer must receive, in writing, the finance charge (a dollar amount) and the annual percentage rate or APR (the cost of credit on a yearly basis). Finance charges can range from \$15 to \$30 per \$100 borrowed. This may not seem like a lot of money until you look at the APR for the loan. A credit industry survey found the average APR for a payday loan to be 300 percent.

Internet payday lending can prove particularly troublesome. Consumers are encouraged to apply and receive loan funds deposited overnight in their bank accounts by filling out online applications and/or faxing applications and support documents. In addition to the high credit costs, which may not be openly disclosed, the study found that consumers who shop for payday loans online face other challenges:

- Lenders may be hard to locate or impossible to contact. Some hide behind anonymous domain registrations or may be located outside the U.S. The borrower can face difficulties communicating with Web lenders regarding any questions they may have or to resolve disputes that may arise.
- Internet payday lenders can bypass state usury laws and consumer protections by locating in states with lax regulations. They can make loans without complying with the licensing requirements or other protections of the borrower's home state.

- Completing online payday loan applications can expose the borrower to privacy and security risks if the lender does not abide by strict privacy policies or the Web site is not secure.

The Better Business Bureau, along with the Federal Trade Commission, advise consumers to consider other possibilities before deciding on a payday loan:

- If you need credit, shop carefully. Consider a small loan from your credit union or a small loan company, an advance on pay from your employer or a loan from a family member or friend.
- Ask your creditors for more time to pay your bills. Find out what they will charge for that service - as a late charge, an additional finance charge or a higher interest rate.
- If you need help working out a debt repayment plan with creditors or developing a budget, contact your local consumer credit counseling service. There are non-profit groups that offer credit guidance to consumers for little or no cost.

Finally, contact your local Better Business Bureau at BBB.org for information on any lender you may be contemplating doing business with.